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Classified By: Deputy Chief of Mission Daniel Piccuta. Reasons 1.4 (b/d).

2008 a Year of Challenges

¶1. (C) The upcoming 5th round of the U.S.-China Senior Dialogue kicks off an important year for China and for bilateral relations. Taiwan's presidential and UN referendum votes in March and the PRC's hosting of the Olympics in August are the focus of Chinese concerns, and the Chinese believe the United States plays a key role in how both play out, presenting distinct challenges to our relations. Actors inside and outside of China will continue to attempt to use China's perceived vulnerability in this Olympic year to advance their agendas. Meanwhile, President Hu Jintao and the new Politburo selected in late 2007 are refining and implementing the foreign policy that will govern China's international relations for at least the next five years. That policy, which confirms that China is largely a status quo power whose main interest is maintaining a stable international environment so that China can focus on the Herculean task of managing its economic development, contains the seeds of continuing U.S.-China disagreement over the treatment of problematic states, such as Iran, Burma and Sudan. Below we offer context and background for key areas of our engagement with China in the coming year.

Taiwan: Concern over UN Referendum

¶2. (C) In the Senior Dialogue in Guizhou and at bilateral meetings in Beijing, Chinese leaders will stress the primacy of the Taiwan issue in our bilateral relations, note that this is a "highly sensitive period" and urge the United States not to send "wrong signals" (i.e., sell arms or allow visits by officials in either direction). Beijing continues to express serious concern over the Democratic Progressive Party's (DPP) referendum on joining the UN "in the name of Taiwan," to be held in conjunction with the March 22 Taiwan presidential election, because China views the referendum as yet another provocative act by President Chen Shui-bian to bolster his constituents' sense of a Taiwan national identity and move the island toward de jure independence. (A competing KMT-proposed referendum on UN membership under the name "Republic of China" does not present the same independence threat to the PRC.)

¶3. (C) Burned by overplaying its hand in the run-up to previous Taiwan elections and recognizing that bellicose PRC expressions only strengthen the DPP's position, Beijing this time around has chosen to seek U.S. assistance in efforts to restrain Chen and warn Taiwan against steps that could be destabilizing for cross-strait relations. PRC officials have expressed appreciation for U.S. opposition to the referendum to date, especially Deputy Secretary Negroponte's interview

on Phoenix TV last August and Secretary Rice's news conference on December 21, but continue to push for even higher-level public opposition from Washington. Chen Shui-bian's planned transits of Alaska to and from his trip to Central America and the Caribbean January 13 and 17 will no doubt elicit Chinese complaints. Beijing will also urge U.S. vigilance against any "dirty tricks" PRC Taiwan experts are claiming Chen may employ to further his personal or independence agendas, which they argue could spark unrest in Taiwan.

14. (C) A range of Chinese observers and policy advisors have told us that passage of the UN referendum alone is unlikely to serve as a sufficient cause for the use of force against Taiwan, but these same contacts have cautioned that the decision is ultimately up to China's highest leaders and that Taiwan's interpretation of the referendum's legal status will be important. Our contacts assert that there are "hard-liners" within the system pushing a tough line on Taiwan. Beijing has previously stated that it will not tolerate Taiwan independence "in any form" nor stand idly by if Taiwan descends into chaos. In response, we have warned that no one in the United States would see the use of force by China as a reasonable response and that a military conflict in the Strait would be a catastrophe for U.S.-China relations. Chinese observers will be watching the outcome of Taiwan's January 12 Legislative Yuan (LY) elections, which will also include votes on two referenda, as a possible preview of the March 22 presidential election and UN referenda.

Post-Party Congress Domestic Political Context

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15. (C) Last October's 17th Communist Party Congress will shape Chinese domestic politics for the next five years. The Congress enhanced Hu Jintao's authority, "electing" him to another five year term as Party General Secretary and Chairman of the Central Military Commission, while at the same time ensuring stability atop the Party by elevating to the nine-member Politburo Standing Committee (PBSC) four new leaders that represent a balance of Party factions, thus ensuring the "collective" nature of the Party's senior leadership. Two of the new leaders are in their fifties and are now positioned to assume leadership of the Party when Hu's term expires in 2012: Xi Jinping, the "princeling" son of a revolutionary leader who has broad popularity and experience within the Party, and Li Keqiang, long viewed as a Hu Jintao protege. Xi is ranked ahead of Li on the PBSC and is seen as having the inside track to succeed Hu as Party General Secretary.

16. (C) The Party Congress also outlined China's policy priorities through 2012, namely continuing the economic reform that has brought China such stunning growth over the last 30 years, while at the same time implementing Hu Jintao's "Scientific Development" and "Harmonious Society" concepts designed to alleviate the inequalities, uneven development and environmental degradation brought about by the previous growth-at-all-costs mentality. These measures are designed to shore up the Party's hold on power and ensure domestic stability. Part of this effort entails being seen as cracking down on endemic official corruption. Despite the endorsement of Hu's policies at the Party Congress, the question is whether he will be able to implement these laudable objectives in the face of significant challenges, including vested interests, recalcitrant provincial officials, the sheer scale of China's social problems and the Party's insistence on maintaining its total hold on power.

Upcoming "Legislative" Session

17. (C) The next significant event on China's political

calendar is the March 2008 session of the National People's Congress (NPC), China's nominal legislature and "highest organ of state power" but in reality an annual session of carefully scripted political theater designed to legitimate Party decisions. Because this year's NPC session is the first following the five-yearly Party Congress, it will be responsible for "electing" China's new Government leaders to five-year terms, to include the President and Vice President; Premier, four Vice Premiers, five State Councilors and other State Council (cabinet) members, among others. Hu Jintao will be "reelected" to another five-year term as President, and incumbent Premier Wen Jiabao and incumbent NPC Chairman Wu Bangguo are also expected to be "reelected." The Vice Presidency and several Vice Premier and State Councilor slots will change, with many observers speculating that Xi Jinping will become Vice President, further cementing his status as Hu Jintao's heir apparent. Li Keqiang is expected to become Executive Vice Premier. China's Senior Dialogue delegation head, the well-connected Executive Vice Foreign Minister and head of the Party's Central Foreign Affairs Office Dai Bingguo, is expected to replace Tang Jiaxuan as State Councilor, thereby becoming the seniormost Government figure solely responsible for foreign affairs.

18. (C) The NPC will also approve the Premier's Government Work Report and a state budget, both of which will reveal specific policy measures the state will adopt to implement Party priorities. The NPC will devote most of its attention to management of the economy, addressing everything from overheating (GDP growth exceeded 11 percent in 2007) and inflation to energy conservation and soaring housing prices. Dealing with pressing social issues and attempts to bring about a "Harmonious Society," especially in the countryside and poor interior regions of China, will be another priority at the NPC. Although foreign policy and defense matters will not be the session's primary focus, the NPC will announce a new defense budget (last year's increased officially by nearly 18 percent), and leaders will surely be keen to demonstrate resolve in opposing Taiwan independence. Significant political reform is not in the cards, but the NPC may announce certain new "structural reform" measures designed to enhance Government efficiency, including a plan to reduce and streamline the number of central Government bodies, in part by creating several new "super ministries."

Human Rights and the Olympics

19. (C) Activists in and out of the PRC have sought to take advantage of the scrutiny brought by the August 2008 Olympics

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to push for improvement in China's human rights record. Chinese leaders have vigorously opposed linking human rights to the Games and instead are intent on putting on a spectacular, incident-free show to serve as China's "coming out party." In the lead-up to the Olympics, Chinese authorities have tightened controls over the media, religion, NGOs and other activists. Albeit imperfectly, China instituted relaxed regulations on foreign journalists beginning in early 2007, but domestic journalists did not benefit from any similar loosening of tight media rules.

110. (C) We have refrained from directly linking the Olympics and human rights and resisted calls to boycott (or hint at a boycott) the Games while at the same pointing out to Beijing that other groups will continue to do so and that China should look at the Games as an opportunity to demonstrate progress on these issues. When he announced his intention to attend the Olympic Games, President Bush said the Games provide China with an opportunity to demonstrate its commitment to greater openness and tolerance. China has yet to show that it plans to seize this opportunity. Beijing continues to suppress critics of the regime and, despite agreement to do so at the last round of the Senior Dialogue, has refused to restart our bilateral human rights dialogue.

MFA officials have repeatedly stated that the "atmosphere" for restarting the dialogue is not right in light of the warm reception we have given Uighur activist Rebiya Kadeer and Tibetan spiritual leader Dalai Lama, both of whom the PRC considers "anti-China splittists."

China's Growing, but Limited, International Clout

¶11. (C) China, whose regional and global influence is growing, is for the most part a status quo power seeking a peaceful international environment that will allow it to focus on domestic economic development. Traditionally, the Chinese adhere to a nominal policy of noninterference in the internal affairs of states. If international intervention in situations is unavoidable (such as in Sudan, where China's interest in forestalling international action began to conflict with its interest in a successful Olympic Games), China prefers the intervention be conducted by multilateral organizations in which it has influence, including the UN. China is careful to seek good relations with neighboring states and sees regional organizations that include China but not the United States (e.g., the Shanghai Cooperation Organization and the ASEAN-plus-3) as useful vehicles for pursuing Chinese regional interests. Motivated by a desire to protect China's image in the run-up to the Olympics, Chinese officials have increasingly acknowledged China's stake in fighting regional and global problems like proliferation, terrorism and climate change. China's pragmatic flexibility has limits, however. When Chinese territorial sovereignty interests like Taiwan, Tibet, or the South China Sea are at stake, China is stubbornly hardnosed, and its energy hunger influences its foreign policy.

China's Energy Diplomacy

¶12. (C) As the world's number two energy consumer, China identifies securing stable energy supplies for its rapidly growing economy as a core interest. China uses development aid, lucrative contracts and vigorous diplomacy to cultivate major energy exporters, including unsavory regimes. We assess positively China's participation in international peacekeeping operations, especially in Africa, and increasing (albeit reluctant) willingness to bring pressure on regimes that violate international norms such as Iran, Burma, Sudan and the DPRK. However, China's interest in playing a responsible role in the international community is balanced against its interest in securing and maintaining long-term access to energy supplies, as demonstrated by high-profile deals with Iran, Burma and Sudan. China and the United States have engaged in effective, mutually beneficial diplomacy to secure the denuclearization of the Korean Peninsula, but in the case of Iran, China's willingness to cooperate with us is compromised by its interest in securing access to Iranian oil and gas.

Military Modernization

¶13. (C) China's military modernization program continues at a fast pace. Sustained investment in military construction and modernization projects is beginning to show results. Defense spending is climbing, with an emphasis on quality-of-life improvements such as pay, housing and new uniforms, as well as the acquisition of sophisticated weapons systems. Beijing

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officially acknowledges that defense spending increased 17.8 percent in 2007 but claims that a high proportion of the defense budget is dedicated to salary increases and improvements in living conditions for military personnel. While this is likely true, it ignores the fact that approximately one-half to two-thirds of China's defense spending is not reflected in published defense expenditures. Weapons development, retirement salaries and foreign

acquisitions, including of Kilo submarines, Sovremenny-class guided missile destroyers and SU-27/SU-30 aircraft, are not covered in official figures. Despite the PLA's resource constraints, strong economic performance combined with the absence of an external threat has afforded China the opportunity to invest in modern equipment. The January 2007 anti-satellite test, which the Chinese have still not adequately explained, exemplifies a key problem with China's military modernization: a lack of transparency. The combination of new weapons systems, improved training and increased operational ranges gives the PLA confidence in its ability to respond to a wider range of threat scenarios.

Key Opportunity

¶14. (C) This session of the Senior Dialogue is an important opportunity to get our message across to the Chinese. The Chinese leadership has a positive impression of the Deputy Secretary dating back to his trip here in connection with

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President Nixon in 1972, reinforced in August by his interview with Phoenix TV on the subject of Taiwan. EVFM Dai has commented on the "warm feeling" he had during the last Senior Dialogue session at Wye River in June, which is why he wants to hold this session in Guizhou, his home province. His perception of a personal connection with the Deputy Secretary, so important to the Chinese, combined with the

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fact that he is a foreign policy heavyweight with at least five years of increasing influence ahead of him, creates an environment conducive to a productive discussion. The Chinese leadership's perception that the United States is in a position to mitigate the negative consequences of the Taiwan votes in March and contribute to a successful Olympic Games this summer means that they will be particularly receptive to the messages delivered at the Senior Dialogue.

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